Christopher L. Reive, OSB # 833058
E-mail: chris.reive@jordanramis.com
David A. Rabbino, OSB #106348
E-mail: david.rabbino@jordanramis.com
JORDAN RAMIS PC
Attorneys at Law
Two Centerpointe Dr 6th Flr
Lake Oswego OR 97035
Telephone: (503) 598-7070
Facsimile: (503) 598-7373

Robert M. Horkovich, *Admitted pro hac vice*
E-mail: Rhorkovich@andersonkill.com
ANDERSON KILL P.C.
1251 Avenue Of The Americas
New York NY 10020-1104
Facsimile: (212) 278-1733
Attorneys for Plaintiff Siltronic Corporation

UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

PORTLAND DIVISION

SILTRONIC CORPORATION, a Delaware corporation,

Plaintiff,

v.

EMPLOYERS INSURANCE COMPANY OF WAUSAU, a Wisconsin corporation; GRANITE STATE INSURANCE COMPANY, a Pennsylvania corporation,

Defendants.

Case No. 3:11-CV-1493-YY

SILTRONIC CORPORATION'S OBJECTIONS TO FINDINGS AND RECOMMENDATION [DKT. # 286]

ORAL ARGUMENT REQUESTED

Pursuant to Federal Rule of Civil Procedure 72(b)(2), Siltronic Corporation ("Siltronic") hereby objects to Magistrate Judge Youlee You's Findings and Recommendation ("F&R") dated November 14, 2016 (Dkt. # 286), which recommended denial of Siltronic's Motion to Require

Wausau to Comply with the Court's Order by Paying Defense Costs on Current Basis ("Motion"). (Dkt. # 250.)

I. INTRODUCTION

Siltronic filed its Motion because even though this Court previously determined that: 1) defendant Employers Insurance Company of Wausau ("Wausau") has a duty to defend Siltronic for environmental contamination claims associated with the Portland Harbor Superfund Site ("PHSS") (Dkt. # 194 at pp. 13, 22); (2) Siltronic is entitled to Independent Counsel of its choice to assist in the defense of the claims relating to the PHSS (Dkt. # 237 at p. 32; Dkt. # 248); and, (3) Wausau is "obligated to pay some or all of the attorney fees" incurred by Siltronic's Independent Counsel (*Id)*, Wausau steadfastly has refused requests and demands by Siltronic to pay defense costs as they have been incurred. Wausau's refusal to pay the defense costs incurred has resulted in Siltronic having had to expend in excess of $1.6 million of its own funds for its defense, dollars that properly should have been paid by Wausau pursuant to its duty to defend as recognized by the Court. In recommending denial of Siltronic's motion, Judge You's F&R (Dkt. # 286) misinterpret and misapply these prior rulings, impose a legal requirement nowhere found in law, and misconstrue key facts.

II. SUMMARY OF OBJECTIONS

As discussed in greater detail below, Siltronic objects to Judge You's F&R on two primary grounds. First, Siltronic objects to Judge You's legal determination that Siltronic is required to demonstrate a breach of the duty to defend before Siltronic's insurance companies are required to comply with applicable law and fund the defense of the environmental claims pending against Siltronic. (Dkt. # 286 at pp. 9-12.) This is a misstatement of applicable law. Second, Siltronic objects to Judge You's factual finding that Siltronic failed to present evidence that it only was seeking legal fees incurred by its Independent Counsel for defense of the environmental claims (Dkt . # 286 at p. 15), and then using this erroneous factual finding as a basis for not requiring Siltronic's insurance companies to pay these defense costs.

III. ARGUMENT

A. There Is No Prerequisite Of "Breach" Before A Duty To Defend Is To Be Funded

Notwithstanding agreeing that the Second Amended Order of September 2, 2015 (Dkt. # 194) imposed a duty to defend all claims against Siltronic relating to legacy MGP and other contamination on Wausau under the 1978-79 coverage, and the March 31, 2016 Order (Dkt. # 237) ruling that the $90,278 NRD payment was a defense payment, Judge You declined to recommend that Wausau be required to actually make the $90,278 payment (let alone the interest that had accrued on that amount over the approximately five years and four months since the claim was tendered[1]) or any other payment for defense costs, including those incurred by Maul Foster & Alongi, Siltronic's environmental consultant, and DEQ oversight costs. Judge You did so in large part by erroneously determining that additional "prerequisite findings" were required before she could compel payment of defense costs pursuant to this Court's prior orders. (Dkt. # 286 at p. 9.)

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[1] Wausau ultimately reimbursed Siltronic for the $90,278 payment on or about November 18, 2016. Wausau, however, failed to pay the accrued interest on those costs, and therefore this issue is not moot. Siltronic first tendered these costs to Wausau in approximately 2010. When Wausau refused to pay them, Siltronic eventually paid them in June 2011 to ensure that it did not miss the opportunity to participate in early Natural Resources Damage Assessment ("NRDA") settlement discussions, which Judge Stewart expressly determined provided an opportunity to reduce or limit its potential liability for NRDA's at the Site, and that the costs were therefore "defense cost" required to be paid for by Wausau. (Dkt. # 237 at pp. 11-17.) Pursuant to ORS 82.010, simple interest has been accruing since approximately July 1, 2011 on the $90,278 payment. By Siltronic's calculation, approximately $43,550 in interest accrued on that amount and remains unpaid. Siltronic has demanded that Wausau pay the accrued interest as well.

Contrary to Judge You's recommendation, there is no prerequisite that an insurance company must have "breached its duty to defend" before an insurance carrier is required to pay defense costs. Such a determination would conflict with hornbook insurance law – namely that "[t]he duty to defend runs contemporaneously with the underlying litigation against the policyholder. Therefore, an insurer must pay defense costs, or reimburse the policyholder for the defense costs it paid, as such costs are incurred." John E. Heitz, *et al*., 3-24 New Appleman on Insurance Law Library Edition § 16.06 (emphasis added).

The principle that the duty to defend is immediate and to be funded on a current basis is well stated in the seminal case of *Aerojet-General Corp. v. Transp. Indem. Co.*, 17 Cal. 4th 38, 60, 948 P.2d 909, 922 (1997), *as modified on denial of reh'g* (Mar. 11, 1998). In that case, the California Supreme Court noted, when discussing the scope of an insurance company's duty to defend, that "to defend meaningfully, it [the insurance company] must defend immediately, and to defend immediately, it must defend entirely." *Aerojet-General* at 60. The Court further held that,

> [i]n fulfilling its [the insurance company's] duty, it must undertake reasonable and necessary efforts to avoid or at least minimize liability. To that end, it [the insurance company] must incur reasonable and necessary costs. All this it must do from as early as tender of the defense through as late as conclusion of the action."

Id.

The *Aerojet-General* ruling is consistent with rulings from other courts on this issue. As Siltronic noted in its reply brief in support of its motion, "without contemporaneous payment of defense costs this insurance 'would not truly protect the insureds from financial harm caused by suits against them.'" *McGinniss v. Employers Reinsurance Corp.*, 648, F.Supp. 1263 (S.D.N.Y 1986). For the duty to defend to have meaning, the starting point of an insurance company's obligation to provide a defense is immediate, and a court need not require a showing of a breach of that duty before a Court can order an insurance company to provide a fully funded defense. By omitting any reference or analysis on this point, Judge You's F&R ignores the applicable law.[2]

The prerequisite of breach that Judge You discusses in her F&R exists, but comes into play in a different context. In cases where a breach has already been determined, there is a prerequisite that applies only to the burden of proof on defense costs. As discussed in *Aerojet-General*,

> In the general case, it is the insured that must carry the burden of proof on the existence, amount, and reasonableness and necessity of the site investigation expenses as defense costs, and it must do so by the preponderance of the evidence . . . By contrast, in the exceptional case, wherein the insurer has breached its duty to defend, it is the insured that must carry the burden of proof on the existence and amount of the site investigation expenses, which are then presumed to be reasonable and necessary as defense costs, and it is the insurer that must carry the burden of proof that they are in fact unreasonable or unnecessary.

Aerojet-General at 64.

In other words, the "prerequisite" of showing a breach only is relevant to whether the policy holder or the insurance company has the burden of proving whether defense costs were "reasonable and necessary." It does not alter the general rule that the duty to defend is immediate and current. In the absence of a breach of the duty to defend, the policy holder has the burden of proving the "reasonable and necessary" amount of defense costs. If there is a breach of the duty to defend, the burden of proof shifts, and the policy holder gets the benefit of the presumption that the defense costs it incurred were reasonable and necessary. But most importantly, whether or not breach is shown, there is an immediate and current duty to defend;

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[2] Siltronic incorporates herein by reference the analysis and citations contained within its Reply to Wausau's Opposition to its Motion to Require Wausau to Comply with this Court's Order (Dkt. # 260 at pp. 4-8).

not five or more years after the fact, or when an insurance company unilaterally determines if and when it will or will not honor its contractual and Court-ordered obligations.

In short, the "prerequisite" relied upon by Judge You does not impact or address the question of whether the duty to defend requires the current payment of defense costs; current payment of defense costs clearly is required. Siltronic's tender of the environmental claims triggered that obligation on its insurance companies, and this Court's prior rulings confirmed that obligation. Judge You's "prerequisite" only impacts the allocation of the burden of proof regarding the reasonableness and necessity of the defense costs. Accordingly, Judge You's F&R are in error by improperly inserting an element into the duty to pay defense costs with no basis in contract or case law.

Removing the improperly inserted "prerequisite" element from the analysis, what was before Judge You was a motion to enforce a prior court order, an order that Wausau cannot dispute it has failed to comply with. Judge Stewart's prior ruling required Wausau to pay the $90,278 that enabled Siltronic to participate in the NRDA (and impliedly all of the statutorily accrued interest of $43, 550), as well as all other defense costs, including "some or all" of Siltronic's Independent Counsel fees that have accrued since June 2013 to assist in Siltronic's defense of the environmental claims (Dkt. # 237 at p. 32), which now exceed approximately $800,000. Siltronic's right to Independent Counsel and Wausau's obligation to pay the Independent Counsel fees incurred in defense of the environmental claims was reinforced in Judge Stewart's June 10, 2016 Order regarding Wausau's Motion for Reconsideration. (Dkt. # 248.) Judge Stewart's orders were not conditioned in any manner that would permit Wausau to delay or otherwise avoid living up to its obligations and paying all defense costs, including the Independent Counsel fees and permissible interest that have accrued since June 2013.

Wausau does not dispute its failure to pay any of these defense fees, but rather tries to justify its noncompliance simply by stating that it disagrees with Judge Stewart's ruling. Wausau did not seek interlocutory appeal. Wausau simply elected not to comply with Judge Stewart's orders.[3]

Wausau's actions flout the authority of this Court. But rather than enforce Judge Stewart's prior orders that Wausau blatantly has elected to ignore, Judge You instead mistakenly imposed a requirement on the policyholder, Siltronic, to bear the burden of proving a "breach" of the duty to defend by Wausau before being able to obtain the benefits of that duty owed to Siltronic pursuant to the insurance policies it purchased from Wausau. Judge You erred in doing so.

B. Siltronic Has Been Clear That It Only Sought Counsel Fees Relating To Its Defense

In her F&R, Judge You noted that Judge Stewart's March 31, 2016 Order (Dkt. # 237 at p. 32) expressly held that "Wausau is obligated to pay some or all of the attorney fees incurred by Mr. Reive since June 2013 to protect Siltronic's interest" as a result of Jordan Ramis being selected by Siltronic as its Independent Counsel pursuant to ORS 465.483. Notwithstanding acknowledging Judge Stewart's ruling, Judge You declined to recommend that Wausau be required to pay the fees incurred by Siltronic's Independent Counsel by finding that "it is not clear whether the fees for which Siltronic now seeks reimbursement are for coverage or defense work or both," and that "[t]his is a factual determination that must precede any order compelling payment." (Dkt. # 286 at p. 15). Siltronic, however, made that specific factual showing in its motion.

[3] It should be noted that at the time of Judge Stewart's March 31, 2016 (Dkt. # 237) ruling and her ruling on Wausau's Motion for Reconsideration (Dkt. # 248), all parties had consented to allow her to make final orders and judgments pursuant to FRCP 73 and 28 U.S.C. § 636(c).

Siltronic stated in its motion that it did "not seek immediate recovery of its litigation fees incurred in this lawsuit [the coverage action]; that claim is reserved for another day." (Dkt. # 250 at p. 7). Siltronic believes this statement clearly demonstrates that Siltronic was not seeking the recovery of its litigation fees in this coverage matter, but rather only was seeking recovery of fees incurred by Jordan Ramis in its capacity as Siltronic's Independent Counsel. To the extent a "factual determination" was required that Siltronic was not seeking recovery of counsel fees for coverage litigation, Siltronic's representation in its motion made that clear.

Wausau was ordered to pay "some or all" of Siltronic's Independent Counsel fees. Wausau has elected to pay none. To the extent Wausau wishes to contend that some of the Independent Counsel fees were not "reasonable and necessary" to Siltronic's defense, that inquiry can be made and, if Wausau meets its burden of proof, potentially adjusted. The record is clear, however, that the fees that were being sought in Siltronic's motion only were those Siltronic asserts were incurred in defense of the PHSS claims pending against it. Judge You was in error in finding otherwise.

IV. CONCLUSION

Siltronic objects to the November 14, 2016 Findings and Recommendation of Judge You (Dkt. # 286) insofar as they recommend denial of Siltronic Corporation's Motion to Require Wausau to Comply with this Court's Orders by Paying Defense Costs on Current Basis (Dkt. # 250) by improperly requiring Siltronic to demonstrate that Wausau has breached its duty to defend as a prerequisite to Wausau being obligated to actually pay defense costs and by finding that Siltronic was not presently entitled to reimbursement of defense cost incurred by its Independent Counsel because Siltronic had failed to make clear that only those fees were being sought.

As a matter of law, Wausau's obligation to fully fund Siltronic's defense against the PHSS claims is not conditioned on a finding that Wausau has breached its duty to defend. Wausau's obligation to fund Siltronic's defense began immediately upon Siltronic's tender of the claims. Judge You's recommendation that Siltronic must show a breach of the duty to defend before being entitled to a fully funded the defense is wrong as a matter of law.

Siltronic also made clear on the record that the legal fees being currently sought are only those incurred by its Independent Counsel while assisting in the defense of the PHSS claims, not any legal fees related to this coverage matter. Judge You's finding that this issue remained open is wrong as a matter of fact.

For the reasons set forth above, Siltronic objects to Judge You's Findings and Recommendation (Dkt. # 286) and requests that this Court modify them accordingly.

Dated this 5th day of December, 2016.

By: *__/s/ Robert M. Horkovich__*
ROBERT M. HORKOVICH
Admitted pro hac vice
ANDERSON KILL PC
rhorkovich@andersonkill.com
Telephone: (212) 278-1322
Facsimile: (212) 278-1733

CHRISTOPHER L. REIVE, OSB # 833058
DAVID A. RABBINO, OSB # 106348
JORDAN RAMIS PC
chris.reive@jordanramis.com
david.rabbino@ jordanramis.com
Telephone: (503) 598-7070
Facsimile: (503) 598-7373

Of Attorney(s) for Plaintiff Siltronic Corporation

CERTIFICATE OF SERVICE

I hereby certify that on the date shown below, I served a true and correct copy of the foregoing SILTRONIC CORPORATION'S OBJECTIONS TO FINDINGS AND RECOMMENDATION [DKT. # 286] on:

W. David Campagne
Stephen R. Wong
Sinnott, Puebla, Campagne & Curet P.C.
555 Montgomery St. Ste. 720
San Francisco CA 94111
Facsimile: (415) 352-6224
E-mail: dcampagne@spcclaw.com
E-mail: swong@spcclaw.com
Attorneys for Defendant Granite State Insurance Company

Thomas W. Brown
Cosgrave Vergeer Kester LLP
888 SW Fifth Ave Ste 500
Portland OR 97204
Facsimile: (503) 323-9019
E-mail: tbrown@cosgravelaw.com
Attorneys for Defendant Granite State Insurance Company

Bryan M. Barber
Barber Law Group
525 University Ave Ste 600
Palo Alto CA 94301-1921
Facsimile: (415) 273-2940
E-mail: bbarber@barberlg.com
Attorneys for Defendant Employers Insurance Company of Wausau

Robert M. Horkovich
Anderson Kill P.C.
1251 Avenue Of The Americas
New York NY 10020-1104
Facsimile: (212) 278-1733
E-mail: Rhorkovich@andersonkill.com
Attorneys for Plaintiff Siltronic Corporation

Barry J. Goehler
Law Office of Barry J. Goehler
1001 SW 5th Ave Ste 1530
Portland OR 97204
Facsimile: (503) 820-2513
E-mail: goehleb@nationwide.com
Attorneys for Defendant Employers Insurance Company of Wausau

[X] by ECF.

DATED: December 5, 2016.

/s/ David A. Rabbino
David A. Rabbino, OSB # 106348
Of Attorneys for Plaintiff Siltronic Corporation